

BEFORE THE BOARD OF MILK CONTROL
OF THE STATE OF MONTANA

In the matter of the amendment of) NOTICE OF AMENDMENT
ARM 32.24.480 producer pricing)
rules)

TO: All Concerned Persons

1. On July 6, 2018, the Board of Milk Control published MAR Notice No. 32-18-290 pertaining to the public hearing on the proposed amendment of the above-stated rule at page 1219 of the 2018 Montana Administrative Register, Issue Number 13.

2. The board has amended the above-stated rule as proposed.

3. The board has thoroughly considered the comments and testimony received. A summary of the comments received and the board's responses are as follows:

COMMENT 1: Dave Lewis, who is a Montana producer, submitted a comment that noted that the proposed rule amendment will help Montana producers have more comparable butterfat prices to the rest of the nation and will still provide a discount to processors that is about 16% of the current difference between national butterfat prices and the Montana Class III butterfat price. He noted that Montana dairy farmers receive amongst the lowest prices for milk in the United States, even though a large percentage is bottled as Class I milk. He hopes that the change in the Class III butterfat price formula will entice more processing of cream products in Montana.

RESPONSE: The board thanks the commenter for the comment. The comments received are consistent with and support the justifications presented in the rulemaking proposal's statement of reasonable necessity.

COMMENT 2: The Montana Milk Producers Association (MMPA) submitted a comment that urged the board to withdraw the proposed rulemaking and develop a broader rule proposal, rather than only changing the Class II and Class III price formulas. MMPA expressed concern that the proposed amendments may put processing plants in Montana out of business and thereby not benefit Montana producers. MMPA stated its belief that the board is inadvertently creating market advantages for certain companies, which MMPA believes is inappropriate. MMPA noted that some recommendations in the Montana Milk Market Regulation Study Final Report (study) published in June 2018 have not been addressed in the rulemaking process. MMPA stated that the proposed amendments potentially create upheaval and challenges for Montana producers and processors.

RESPONSE: The board thanks the commenter for the comment. The board received no evidence that the proposed amendments will cause Montana plants to

close and did not receive any comments from distributors operating plants in Montana. Likewise, the board received no proposed alternatives to the rulemaking proposal. The board believes that the proposed amendments are supported by evidence presented to it. Several recommendations in the study were for the board not to act, such as seasonal pricing for Class I milk. The study also included recommendations about Montana's quota system and statewide pooling arrangement that would not impact Montana processors' cost for milk produced in Montana. The study did not recommend a single-phase rulemaking process that addressed all proposals concurrently. Accordingly, the board is immediately addressing the recommendations that are most readily actionable. The board notes that following completion of the study it distributed a survey to producers and processors to allow those groups to rate the importance of addressing the study's recommendations. Upon further consideration of the results of this study, the discussion about the study, and the condition of the Montana dairy industry, the board may engage in additional rulemaking. The board notes that the price formulas apply equally to all Montana processors based upon how each processor utilizes milk produced by Montana producers. The board's rulemaking is based on the evidence it receives. The board has considered amending Class III price formulas since before it commissioned the study. In December 2016, the board received an informal petition from producers drawing attention to their concern about Montana's Class III pricing structure. At the August 31, 2017 board meeting, the board tabled discussion to adjust the Class III price formulas until it received the draft study report. On April 30, 2018, after receiving the draft study report, the board instructed the Milk Control Bureau to draft a rule proposal to amend Class III and Class II price formulas. The board does not agree that the proposed amendments need to be withdrawn or be changed.

4. Written findings and conclusions pursuant to 81-23-302(7), MCA:

Findings:

- 1) The board proposed to revise the Class II and Class III price formulas based upon facts within its own knowledge. These facts include the data collected by the Milk Control Bureau; the data contained in the Montana Milk Market Regulation Study Final Report, authored by Dairy Technomics LLC; the data contained in the small business impact statement for this proposal; and data considered by the Board of Milk Control at its June 25, 2018 meeting. These facts provided the board information for it to consider regarding the balance between production and consumption of milk, the costs of production and distribution, and prices in adjacent and neighboring areas and state. When the board published the notice of proposed rulemaking, it notified the consuming public and the milk industry of the specific facts within its own knowledge so that all interested parties had opportunity to be heard and to question or rebut the facts as a matter of record.
- 2) No comments were received regarding the proposed amendments that questioned or rebutted the facts upon which the board relied.
- 3) No comments were received that proposed alternatives to the proposed amendments.

4) Most milk in the United States is covered by minimum price regulations, with the majority of jurisdictions basing prices on prices announced by the United States Department of Agriculture Agricultural Marketing Service (USDA-AMS).

5) Montana uses the same definitions of classes of utilization of milk as USDA-AMS, except that Montana combines the Class III and Class IV definitions into a single class, Class III.

6) USDA-AMS publishes two price announcements used in federally regulated markets to establish the value of producer milk. The USDA Announcement of Advanced Prices and Pricing Factors announces advance prices that are used to value Class I skim milk and butterfat and Class II skim milk. The USDA Announcement of Class and Component Prices announces prices after the month of production and utilization that are used to value Class II butterfat, Class III skim milk and butterfat, and Class IV skim milk and butterfat. The price formulas underlying both price announcements are the same, but the reference price data collection periods are different.

7) The current Montana Class II and Class III price formulas are different than federal price formulas for Class II, Class III, and Class IV milk in terms of price formula structure and reference price data collection periods.

8) Montana currently announces producer milk prices in advance of production and utilization for all classes of milk. The proposed Montana Class II and Class III price formulas would result in advanced price announcements. Advanced prices provide a benefit to processors in terms of financial planning, product pricing, and operational planning, since advanced prices establish the unit raw product cost prior to the purchase and utilization of milk. Advanced prices improve the ability of producers to estimate the blend price they will receive for their milk.

9) Compared to the price formulas for Class II and Class III currently in use, the proposed price formulas would have collectively increased revenue to Montana producers in calendar years 2015 - 2017 by approximately 3.5% - 4.4%, dependent upon which proposed Montana Class III Butterfat Price Differential would have been in effect. The proposed Class III butterfat price formula would have accounted for nearly all of the increase.

10) The current structure of the Class III butterfat price formula causes the Montana Class III butterfat price to be substantially lower than Class III butterfat prices in most other regulated markets in the United States and for which the difference between the Montana Class III butterfat price and federal Class III butterfat price increases as national butter prices increase. In the 2015 – 2017 time period, the current Montana Class III price formula resulted in Class III butterfat prices that were 12.89% - 41.59% lower (or \$0.3233/lb to \$1.2627/lb lower) than the USDA Advanced Butterfat Pricing Factor.

11) The approximate impact the proposed amendments would have had in 2015 - 2017 to distributors' costs compared to current rules for the skim and butterfat portions of Class II and Class III utilization values are as follows:

a) dependent upon which proposed Montana Class III Butterfat Price Differential would have been in effect, the proposed amendments to the Class III price formulas would have increased distributors' costs for the butterfat portion of milk utilized in Class III by approximately 18.1% - 23.5%;

- b) the proposed amendments to the Class III price formulas would have decreased distributors' costs for the skim milk portion of milk utilized in Class III by approximately 1%;
- c) the proposed amendments to the Class II price formulas would have increased distributors' costs for the butterfat portion of milk utilized in Class II by approximately 4%;
- d) the proposed amendments to the Class II price formulas would have increased distributors' costs for the skim milk portion of milk utilized in Class II by approximately 1%; and
- e) the total utilization value of pool milk would have increased by 3.5% - 4.4%, dependent upon which proposed Montana Class III Butterfat Price Differential would have been in effect.

12) The Milk Production, Disposition, and Income 2017 Summary authored by the United States Department of Agriculture National Agricultural Statistics Service in April 2018 shows that Montana producers had among the lowest all milk average returns (per cwt) in 2017 and 2016 in the United States. The Montana Milk Market Regulation Study Final Report (June 2018) noted that with the exception of Idaho in 2017, the net price for milk per cwt paid to producers in Montana is the lowest in the region and at or near the bottom in the country.

13) The following recommendations regarding Montana's class price formulas were made by Dairy Technomics, LLC in its June 2018 Montana Milk Market Regulation Study Final Report, which considered prices in adjacent and neighboring areas and states and costs of production and distribution:

- a) Montana should maintain the Montana Differential of \$2.55 for Class I milk for the immediate future;
- b) Class II should be based on the Federal Order, with Class II butterfat based on advanced pricing; and
- c) Class III pricing should be the lower of Federal Order Class III and Class IV but calculated from advanced pricing; it may be necessary to incorporate some discounts to processors, at least for a period of time, to allow the impact of a change in Class III pricing to be absorbed.

14) The proposed Class III Montana Butterfat Price Differential functions as a discount to the USDA Advanced Butterfat Pricing Factor in the proposed Class III butterfat price formula. The proposed amendments provide for a \$0.10 per pound of butterfat Class III Montana Butterfat Price Differential for Class III butterfat utilized after June 30, 2019, which is approximately a 4% discount from the USDA Advanced Butterfat Pricing Factor.

Conclusions:

- 1) Based upon the evidence produced in public comment and the hearing held August 3, 2018, the board concludes that it may rely upon the facts within its own knowledge when it proposed the amendments.
- 2) The board concludes that the requirements of 81-23-302, MCA, for revising milk pricing formulas have been met.
- 3) The board concludes that the proposed amendments will result in minimum prices that are fair and equitable to producers and consumers.

4) The board concludes that the proposed amendments will result in Class II and Class III prices comparable to regulated jurisdictions elsewhere in the United States.

5) The board concludes that the proposed Class III butterfat price formula will result in a formula that causes Montana Class III butterfat prices to parallel federal Class III butterfat prices and will provide a modest but meaningful discount for distributors to address the impact of the change in Class III pricing and market volatility that may occur from using an advanced price formula based on prices announced in the USDA Announcement of Advanced Prices and Pricing Factors instead of prices announced in the USDA Announcement of Class and Component Prices.

5. This rule amendment is effective September 19, 2018.

/s/ Cinda Young-Eichenfels
Cinda Young-Eichenfels
Rule Reviewer

/s/ W. Scott Mitchell
W. Scott Mitchell
Chair
Board of Milk Control

Certified to the Secretary of State August 28, 2018.